

Message Text

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ACTION ARA-06

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TO SECSTATE WASHDC 2086
INFO TREASURY WASHDC

C O N F I D E N T I A L SECTION 01 OF 03 MEXICO 07305

LIMDIS - PASS FEDERAL RESERVE

EO 11652: GDS
TAGS: EFIN MX
SUBJECT: RECENT ECONOMIC DEVELOPMENTS

1. SUMMARY: PARTIAL DATA PLUS PUBLIC AND PRIVATE COMMENTS BY GOM OFFICIALS INDICATE THAT MEXICO IS MEETING THE FUND PROGRAM TARGETS. ECONOMY CONTINUES TO STAGNATE, CURRENT ACCOUNT DEFICIT DECLINES, PRICE INCREASES CONTINUE AT HIGH RATE. END SUMMARY.

BALANCE OF PAYMENTS.

2. CURRENT ACCOUNT. BANK OF MEXICO DIRECTOR GENERAL HAS PUBLICLY STATED THAT FIRST QUARTER TRADE DEFICIT WAS ABOUT \$100 MILLION AND CURRENT ACCOUNT DEFICIT WAS \$300 MILLION. THIS REPRESENTS A DRAMATIC IMPROVEMENT OVER FIRST QUARTER 1976, WHEN TRADE DEFICIT WAS \$672 MILLION AND CURRENT ACCOUNT DEFICIT WAS \$666 MILLION. ACCORDING TO PRELIMINARY AND UNPUBLISHED DATA OBTAINED ON A CONFIDENTIAL BASIS, EXPORTS WERE UP 33 PERCENT IN VALUE AND IMPORTS WERE DOWN 25 PERCENT. COFFEE ACCOUNTS FOR 30 PERCENT OF THE INCREASED EXPORT EARNINGS, PETROLEUM AND MANUFACTURES

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(MOSTLY AUTO PARTS) FOR 26 PERCENT EACH. THE DECLINE IN CAPITAL GOODS IMPORTS ACCOUNTED FOR OVER HALF OF THE DROP IN IMPORTS.

3. SERVICES, WHICH WERE ROUGHLY IN BALANCE IN FIRST QUARTER 1977, MUST HAVE REGISTERED A DEFICIT OF ABOUT \$200 MILLION IN FIRST QUARTER 1976. POSITIVE BALANCE ON

FRONTIER TRANSACTIONS AND TOURISM WAS \$278.3 MILLION IN JANUARY-FEBRUARY 1977, \$22 MILLION BELOW YEAR EARLIER SURPLUS. HIGHER INTEREST PAYMENTS PROBABLY WERE MAIN FACTOR IN SERVICES DEFICIT.

4. CAPITAL ACCOUNT. DATA IS NOT YET AVAILABLE ON THE CAPITAL ACCOUNT, BUT WE WOULD ESTIMATE NET CAPITAL INFLOWS AT NO MORE THAN \$300 MILLION. PRESUMABLY NET PRIVATE SECTOR BORROWING HAS BEEN NIL, THOUGH AT LEAST ONE PRIVATE EXTERNAL BOND ISSUE HAS BEEN FLOATED. PUBLIC SECTOR NET BORROWING IN THE FIRST QUARTER COULD NOT HAVE BEEN VERY LARGE. WE ARE AWARE OF ONLY FOUR PUBLICIZED ISSUES FOR A TOTAL OF \$440 MILLION. THERE WERE, HOWEVER, NUMEROUS UNPUBLICIZED SHORT AND MEDIUM TERM CREDITS AS WELL. NET PUBLIC SECTOR BORROWING WAS PROBABLY NO MORE THAN \$250 MILLION IN FIRST QUARTER. PROCEEDS OF \$350 MILLION PEMEX ISSUE WERE NOT DRAWN DOWN UNTIL APRIL.

5. IT WOULD APPEAR THAT THE "ERRORS AND OMISSIONS" ENTRY WAS POSITIVE IN FIRST QUARTER. WHILE SOME CAPITAL FLIGHT CONTINUES, REFLows WERE GREATER, ACCORDING TO MOST REPORTS. AS BEST WE CAN DETERMINE, REFLows TOOK THE FORM OF SALES OF DOLLAR CURRENCY BEING HELD IN MEXICO RATHER THAN INTER-BANK FLOWS. THERE IS NO SIGNIFICANT REPATRIATION OF CAPITAL HELD ABROAD, ACCORDING TO U.S. AND MEXICAN BANKERS. GROSS RESERVES INCREASED \$205 MILLION FROM END-DECEMBER TO MARCH 11.

6. RE PUBLIC SECTOR EXTERNAL BORROWING PROGRAM, WE UNDERSTAND THAT THE 150 MILLION EURO-DOLLAR CREDIT FOR BANOBRAS CONFIDENTIAL

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(PUBLIC WORKS BANK) IS NOT FARING VERY WELL. BANKERS HAVE VOLUNTEERED DIFFERENT REASONS FOR THIS; ONE HAS SAID THAT GOM PICKED A WEAK UNDERWRITING GROUP. ANOTHER SAID THE POOR RECEPTION IS DUE TO BANKS ALREADY HOLDING TOO MUCH BANOBRAS PAPER. A THIRD HAS SAID THAT THE POOR REACTION IS DUE TO CONCERNS RE MEXICAN PAPER. WE ALSO UNDERSTAND THAT A \$60 MILLION UNITED MEXICAN STATES BOND ISSUE FOR FIVE YEARS AT 9 PERCENT HAS JUST BEEN FLOATED IN NEW YORK. THIS ISSUE HAS BEEN IN THE WORKS SINCE BEFORE THE DEVALUATION. PEMEX IS REPORTEDLY NEGOTIATING A EURO-CURRENCY BOND ISSUE, AND THE RURAL BANK IS PLANNING A DM BOND ISSUE.

7. RE BORROWING FROM COMMERCIAL BANKS, RECENT DISCUSSIONS WITH OFFICIALS OF THE THREE LARGEST U.S. BANKS INDICATE A RELUCTANCE TO INCREASE THEIR EXPOSURE IN MEXICO AS FAST AS IN THE LAST TWO YEARS. ONE OFFICIAL TOLD US HIS BANK DID NOT INTEND TO INCREASE EXPOSURE FASTER THAN ITS CAPITAL WOULD GROW; I.E., 10 PERCENT THIS YEAR. ANOTHER KEPT EXPRESSING THE VIEW THAT THE IFI'S SHOULD PLAY A LARGER

ROLE IN FINANCING MEXICO'S CURRENT ACCOUNT DEFICIT. THESE VIEWS PROBABLY REFLECT THOSE OF SENIOR MANAGEMENT. WE HAVE NOT HEARD ANY BANKERS SAY THEY INTEND TO FURTHER REDUCE THEIR MEXICAN PORTFOLIO; SOME INDICATE THEY ARE WILLING TO INCREASE IT JUDICIOUSLY, OTHERS SAY THEY ONLY INTEND TO MAINTAIN THEIR END-76 EXPOSURE BY REPLACING MATURING DEBTS.

8. DOMESTIC ECONOMIC ACTIVITY. INDUSTRIAL OUTPUT REMAINS AT FOURTH QUARTER LEVELS AND IS BELOW YEAR EARLIER LEVELS.

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THERE HAS BEEN NO GENERAL REVIVAL OF PRIVATE INVESTMENT, AS BEST WE CAN DISCERN. WHILE THE PRIVATE BUSINESS COMMUNITY HAS WARM FEELINGS TOWARD LOPEZ-PORTILLO, THEY REMAIN RELUCTANT TO COMMIT FUNDS. THIS REFLECTS LINGERING DOUBTS OVER WHAT THE GOVERNMENT'S POLICIES WILL BE, A RELUCTANCE TO CONVERT DOLLARS INTO PESOS, GENERALLY TIGHT CREDIT, AND STAGNANT DOMESTIC DEMAND. THE LACK OF A CLEARLY STATED SHORT AND LONG-TERM ECONOMIC STRATEGY IS A COMMON COMPLAINT AMONG BUSINESSMEN AND BANKERS. THE JANUARY INDUSTRIAL PRODUCTION INDEX WAS 3.6 PERCENT BELOW THE YEAR-EARLIER FIGURE, AND ALSO SLIGHTLY BELOW DECEMBER INDEX, CONTRARY TO USUAL SEASONAL JUMP. A LARGE MEXICAN PRIVATE BANK ESTIMATES INDUSTRIAL PRODUCTION IN FIRST QUARTER 1977 WAS 4 PERCENT BELOW THAT OF ONE YEAR EARLIER.

9. MONEY SUPPLY IS GROWING ON A YEAR TO YEAR BASIS AT OVER 30 PERCENT. CURRENCY IN CIRCULATION OUTSIDE THE

BANK OF MEXICO AS OF END-MARCH WAS 45 PERCENT ABOVE YEAR EARLIER FIGURE. AS OF END-FEBRUARY, TOTAL MONEY SUPPLY WAS 33 PERCENT ABOVE YEAR EARLIER FIGURE, AND 1.2 PERCENT ABOVE END-JANUARY FIGURE. CURRENCY IN CIRCULATION OUTSIDE THE BANK OF MEXICO WAS 70.3 BILLION PESOS AT END-
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MARCH, NINE BILLION BEPESOS BELOW THE END-1976 FIGURE. THUS, BANK IS WELL WITHIN FUND AGREEMENT PROVISION CALLING FOR THE CURRENCY ISSUE GROWTH NOT TO EXCEED THE CHANGE IN INTERNATIONAL RESERVES.

10. BANK OF MEXICO OFFICIAL TOLD US THAT NET CENTRAL BANK LENDING TO FEDERAL GOVERNMENT IN FIRST QUARTER WAS ABOUT 3 BILLION PESOS, SOMEWHAT BELOW YEAR EARLIER FIGURE. THERE IS NOT ANY DATA YET AVAILABLE FOR LENDING TO PUBLIC SECTOR, BUT THIS IS GENERALLY LESS THAN THE FEDERAL GOVERNMENT'S BORROWING. IT WOULD APPEAR THAT THE PUBLIC SECTOR DEFICIT IN FIRST QUARTER IS WELL WITHIN THAT CALLED FOR IN FUND AGREEMENT.

11. INSOFAR AS NON-MONETARY LIABILITIES OF PRIVATE BANKS INCREASED 20 BILLION PESOS IN FIRST QUARTER ACCORDING TO THE BANK'S DIRECTOR GENERAL, BANK OF MEXICO NET FINANCING TO FEDERAL GOVERNMENT SHOULD HAVE BEEN MANAGED WITHOUT ANY IMPACT ON MONEY SUPPLY. (RESERVE REQUIREMENTS WOULD HAVE CHANNELED 10 BILLION OR MORE OF THIS INCREASE TO CENTRAL BANK.) BANK OFFICIALS HAVE CONFIRMED THIS IN PRIVATE CONVERSATIONS.

12. INTEREST RATE REFORM CONTINUES TO BE POSTPONED. APPARENTLY BECAUSE OF OPPOSITION FROM BANKERS AS GOVERNMENT OFFICIALS HAVE AGREED TO NEED FOR REFORM. REFORM, WHEN IT COMES, STILL PLANNED TO RESEMBLE PACKAGE OUTLINED IN MEXICO 3051.

13. THE PUBLIC SECTOR BUDGET REMAINS A MYSTERY IN PART BECAUSE THERE IS NO DATA FOR THE FIRST QUARTER AND IN PART BECAUSE OF CONTRADICTORY STATEMENTS. NUMEROUS GOVERNMENT OFFICIALS HAVE COMPLAINED TO EMBOFFS OF A LACK OF INVESTMENT FUNDS AND FROZEN OR REDUCED BUDGETS. PUBLICLY, BUDGET SECRETARY TELLO HAS MAINTAINED THAT SPENDING IS RUNNING AT BUDGETED LEVELS. OUR BEST GUESS IS THAT SOME INVEST-
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MENT SPENDING WAS FROZEN PENDING A MORE THOROUGH REVIEW

WHICH RECENTLY CONCLUDED WITH DECISION THAT 1977 SPENDING
SHOULD NOT EXCEED ORIGINAL BUDGET.

14. THE AGREEMENT WITH THE FUND IS BEGINNING TO SURFACE AS A POLITICAL PROBLEM. A DEPUTY HAS SUGGESTED THAT THE CONGRESS SHOULD HAVE A LOOK AT AND DISCUSSION OF THE PROGRAM AS AGREED WITH THE FUND. THE GOM HAS RESPONDED, INDIRECTLY, THROUGH FINANCE MINISTER MOCTEZUMA WHO HAS DEFENDED THE FUND AGREEMENT AS A PROPER EXERCISE OF MEXICO'S SOVEREIGNTY AND, ACCORDING TO MEXICAN NEWSPAPERS, INSISTED IN THE IMF INTERIM COMMITTEE THAT THE FUND NOT VIOLATE THE "SOVEREIGNTY" OF ITS MEMBERS.

15. WHILE GOM OFFICIALS POINT OUT A REDUCTION IN THE RATE OF INFLATION SINCE THE LAST FOUR MONTHS OF 1976, INFLATIONARY PRESSURES REMAIN STRONG. THE WPI INCREASED 2.9 PERCENT IN APRIL AND THE NATIONAL CPI WAS UP 1.5 PERCENT LEAVING THESE INDICES 49.8 PERCENT AND 27.3 PERCENT ABOVE YEAR EARLIER LEVELS. THERE IS STILL CONSIDERABLE REPRESSIVE INFLATION. THIS CERTAINLY EXISTS IN THE PUBLIC SECTOR, BUT MANY PRIVATE BUSINESSMEN COMPLAIN ABOUT THE NEED TO RAISE PRICES OF GOODS SUBJECT TO PRICE CONTROLS. SEVERAL HAVE TOLD US THAT THEY HAVE CUT OFF PRODUCTION LINES RATHER THAN RUN THEM AT A LOSS. THE PRESUMPTION IS THAT ONCE THE 90 BASIC COMMODITIES PROGRAM IS EFFECTIVE, APPROVALS FOR PRICE INCREASES WILL BE GRANTED. (THIS PROGRAM IS PROGRESSING VERY SLOWLY. AGREEMENTS HAVE BEEN REACHED ON MORE THAN HALF THE PRODUCTS WHEREAS IT HAD BEEN HOPED AGREEMENTS ON ALL 90 WOULD BE SIGNED BY MAY 1.) IT IS ALSO WIDELY ASSUMED THAT CERTAIN PUBLIC SECTOR PRICES

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WILL BE RAISED. THUS, IT IS POSSIBLE THAT THE RATE OF INFLATION WILL SPURT IN JUNE. THE GOVERNMENT MAY, HOWEVER, RESIST PRESSURES TO INCREASE CONTROLLED PRICES BECAUSE OF THE IMPACT THIS MIGHT HAVE ON THE EFFORT TO MAINTAIN A 10 PER-CENT CEILING ON WAGE INCREASES.

16. THE APRIL NATIONAL CPI WAS 8.9 PERCENT ABOVE THE DECEMBER LEVEL. ASSUMING ANOTHER 1.4 PERCENT INCREASE IN MAY, THE NATIONAL CPI WILL BE 10.4 PERCENT ABOVE THE DECEMBER LEVEL. THIS WILL MAKE THE GOVERNMENT'S 10 PERCENT CEILING ON WAGE INCREASES MUCH MORE DIFFICULT TO ENFORCE. WHILE THE SPIRIT OF THIS CEILING IS BEING MAINTAINED, SOME SETTLEMENTS ARE MORE COSTLY TO EMPLOYERS BECAUSE OF NEW OR ADDITIONAL FRINGE BENEFITS THAT RAISE THE ACTUAL INCREASE IN EMPLOYEE COSTS ABOVE 10 PERCENT. THOMPSON

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